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Editorial Comment

Our Association's Annual Meeting

This year's annual meeting of The Dominion Association of Chartered Accountants—the forty-second in the life of the Association and the fifth to be held during the course of the present war—will be in Saint John, N.B., in accord with the rotation of annual meetings as set forth by our by-laws. In these times, all transportation and hotel facilities are crowded, but Saint John is only sixteen hours by direct train from Montreal, and adequate accommodation is reserved in its leading hotel. While a New Brunswick member was Dominion president on two earlier occasions, there has been only one annual meeting held in that province, in Saint John in 1932. As host for the 1944 meeting, a committee of the New Brunswick Institute is in charge of arrangements.

In announcing the 1943 annual meeting, we mentioned that "essential business as usual" appeared to be the general principle upon which normal activities were being sustained during the war, and our own annual meetings have been consistent with that idea. As long as professional problems remain acute, and social diversions are restricted, it at least is easy to keep the serious side to the fore. Tax problems will be emphasized during the general sessions, but it is also hoped to devote some time to consideration

of financial statements. Various provincial committees are also co-operating with the Dominion Association in an effort to arrive at the best means for dealing with the problem of student training during and immediately after the war. A tentative program of the meeting is printed elsewhere in this issue.

*The Work of
Parliament*

A survey of the work of the 1944 session of our Dominion parliament can bring only disappointment to any one who looks upon volume of legislation as a virtue, but from a broader viewpoint there is this comforting philosophy, that since parliament can not administer a war, perhaps the less legislation there is, so much the better. Certainly it would be unwise to load our statute books with permanent measures framed in the pressure of wartime. Canada is fortunate in that most of its wartime governmental powers, while adequate to meet any emergency, are subject to automatic expiry upon the completion of the war. The right to declare when the war is over is still an important and probably essential power reserved to the Governor General in Council. Offsetting this, it must be recognized that the aftermath of the war will remain a federal problem for some years, for which purpose some partial extension of authority may be justified. Exactly how this period of reconstruction will be met, constitutionally, is too detailed a question to be settled now. We can at least be certain that since provincial viewpoints vary so greatly, our constitution must stop far short of complete centralization. It further is reasonable to expect that the volumes of orders in council and administrative regulations will in large degree be abandoned in a return to more direct parliamentary or legislative control.

*Accounting and
the Tax Law*

In rendering a decision of The Exchequer Court of Canada early in June, in the case of Kenneth B. S. Robertson Limited vs. The Minister of National Revenue, Chief Justice Thorson stated that "it does not follow that, because an accounting practice is a sound one, it is permissible for income tax purposes." Lest any accountant, who may still cling to the idea of inviolable axioms acquired during the course of his professional training, be alarmed

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at this seeming relegation of authority, we have merely to remind him that if a sovereign legislature declares that black is white, or the moon is made of green cheese, it is so, for purposes of the law within the jurisdiction of that legislature. In other words, what parliament decrees does not have to be right or even sound. As long as its meaning is clear, its laws must apply. One of the reasons why we have common law, and principles of equity, and wide principles of jurisprudence, is because no body of men can legislate on everything that comes within the realm of human experience and consequently of the law.

To refer specifically to accounting, it is universally recognized that depletion of wasting assets, and depreciation of capital assets, are essential considerations in the disposition of receipts. Yet there is no binding obligation on the part of parliament to recognize them for purposes of income tax calculation. Income tax laws do recognize them, because they are in the main designed to be equitable laws, and their authors know that failure to admit such charges would disorganize productive activity.

It is healthy for us to think of such fundamentals occasionally, because in the multiplicity of tax detail that confronts us in these years we are apt to unduly abuse the tax departments for their seeming iniquities. One of the greatest difficulties in tax legislation and administration is to find words which are concise enough to accomplish their purpose and yet not so rigid as to cause injustice. That, incidentally, is why there are so many discretionary powers in our own Canadian tax statutes. Probably the worst fault in our income tax law (and the same situation appears to exist elsewhere) is in its physical form, which has resulted from the piling of amendment upon amendment, and the accumulation of over-riding clauses, which make it hazardous for any person to attempt to interpret the act without a good understanding of its entire contents. On this ground alone, the re-writing of the law is one of the most urgent jobs for the post-war period.

A New Reciprocal Agreement The announcement on 8th June by the Prime Minister, of a reciprocal agreement with the United States whereby duplication in succession duties would be eliminated, is partial relief from one of the worst complications in our entire tax structure. It still leaves duplication of pro-

vincial and Dominion levies, and, as far as is known, state taxes will continue to apply in full. As long as an estate faced dual levies in Canada, plus dual levies (state and federal) across the line, there was always the possibility of the tax exceeding the asset. The task of securing clearances, in addition to the payment of taxes, will still be a burden on executors, where estates are complicated.

In This Issue In this issue of THE CANADIAN CHARTERED ACCOUNTANT we are able to conclude the valuable series of talks given at the staff conference of P. S. Ross and Sons, also the two remaining instalments of the articles on Money. In each case pamphlet reprints will be available within a few days. A recent Exchequer Court decision is reviewed.

"Current Accounting Literature" has been omitted in our June and July issues, but will, we expect, be resumed in August.

About this time each year we publish the sessional amendments to the income and excess profits tax acts, but owing to delay in the federal budget, these will not be available this year until at least our August issue.

A Staff Conference Report

(Addresses given at a recent staff conference of P. S. Ross & Sons.)

ACCOUNTING FOR FACTORY OVERHEAD

By J. Bryant

IN ORDER that overhead may be applied to current costs it is necessary, in practically all cases, that pre-determined rates should be established and used as standards. Otherwise the ascertaining of factory costs will be delayed until such time as all expenses have been recorded and valuable information will be out of date.

The first step, then, is to obtain a complete and clear idea of the methods necessary to establish these standard rates.

It is essential in the establishing of standard overhead rates to prepare a budget or estimate, designed to cover all expenses necessary for a normal yearly production. The information required in the preparation of such a budget can usually be secured from a study of prior costs, trends, etc. The items on this budget are then apportioned over the various departments to arrive at a total overhead for each department.

In preparing normal labour hours or costs for such a forecast it should be remembered that a margin of plant over and above that required for normal production is usual, and that normal production seldom exceeds 80% of capacity. In forecasting expenses the same principle is involved, and variable expenses should be estimated in the light of normal conditions. Fixed charges of a non-variable nature do not require the same consideration.

In order to illustrate and explain the methods used in determining standard rates and distributing departmental expense, we have prepared a chart (cents omitted) based on a 2,500 normal man hours per annum, with average

REPRINTS AVAILABLE SHORTLY

The short addresses by members of the staff of P. S. Ross and Sons, appearing in this and in our June issue, will be available about 15th July in a separate pamphlet entitled "A Staff Conference Report" at 25 cents per copy postpaid.

labour rates applied to the four production departments. We also outline the various overhead expenses applicable to factory costs divided in their respective groups as between fixed and variable expense.

You will appreciate the fact that the time at our disposal does not permit us to elaborate on the numerous divergent methods of standard calculations, so we confine our presentation to generally accepted principles as follows.

Basis of Cost Application

Productive Labour Cost: The use of direct labour cost as a basis of overhead distribution is most commonly used in practice and rightly so where the element of labour predominates, and where wage remuneration represents time spent. In arriving at normal labour cost, due allowance should be made for alterations of awards, normal working conditions, changed methods of production, idle time, vacations, inventory taking, etc.

Productive Labour Hours: The use of direct labour hours is desirable where there are considerable variations in labour rates, especially when wages are calculated on the piece work or bonus system. Again it is the *normal* labour hours we aim to establish.

Prime Cost: This combination of productive labour and material cost as a basis of application is so seldom used as to be of little interest and can only be applied when there are no material or operational variations and the ratio of material to labour is constant.

Machine Hour Costs: The machine hour rate is probably the most accurate method of cost application for the distribution of factory overhead where the machine is a predominant factor, and where extreme refinements of costs are required. There are several methods used in computing machine hour rates, one of which is demonstrated on the chart and groups all machines in the department as a unit of production charged with depreciation, power, maintenance, etc. Another method regards each machine or each group of similar machines as a separate unit to which all expenses, including the time of the operator, and the setting up and taking down expenses are charged.

We now have outlined the principal bases on which overhead is applied. Some companies use a combination of

all four methods and any attempt on our part to illustrate the results in such cases is not possible at this time.

Factory Overhead

Overhead includes all items of cost directly affecting production other than material and labour costs. You will note from the chart (lines no. 12 and 32) that certain expenses of a general nature common to all departments are prorated to the departments on the ratio of the departmental productive labour cost to the total productive labour cost (line 1.A). It is desirable, however, to allocate expenses direct to the department concerned, when the expense can be definitely identified as relating thereto. This has been possible for indirect salaries of the foremen and time-keepers (lines no. 8 and 9). Other types of expenses require still other bases of apportionment, such as:—

Maintenance: Buildings — spread on a basis of floor space occupied (line no. 14); machinery and equipment—spread on basis of machine values, or records supplied from the machine shop (line no. 15).

Depreciation: Buildings—spread on the basis of floor space occupied (line no. 18); machinery and equipment—spread according to capital value of plant being depreciated (not necessarily full book value) (line no. 19).

General Expenses: Taxes—spread on the basis of floor space (line no. 25); insurance—spread according to rates for property insured in each production department (line no. 26); light, heat and power—spread according to horse power rating in each department for power (line no. 27) and on a basis of floor space for light and heat; workmen's compensation—spread according to the amount of wages and salaries paid in each department at the rate or rates charged by the board (line no. 30).

The aforementioned distributions are more or less arbitrary, and if some better apportionment can be obtained it should be used.

After having allocated all items of a factory expense nature to the different departments we are now in a position to determine standard rates of overhead for each department. The chart was designed to give a choice of any one of three most accepted methods as shown on lines no. 35, 36 and 37.

Line No.	FACTORY BUDGET BASED ON PRODUCTION AT 2,500 NORMAL WORKING MAN HOURS (Cents omitted)					Classification			
						Period One Year			
	Average Men Employed	135	40	50		25	50	20	
	Average Labour Rate	44.44	45	35		50	60	60	
	Department	Total	1	2	4	3			
1	Productive Labour Cost	\$150,000	\$ 45,000	\$ 43,750		\$ 31,250	\$ 30,000		
1A	% Ratio to Total	100%	30%	29.17%		20.83%	20%		
2	Labour Cost	150,000	45,000	43,750		31,250	30,000		
3	Material Cost	66,850	20,000	18,500		10,350	18,000		
4	Prime Cost	\$216,850	\$ 65,000	\$ 62,250		\$ 41,600	\$ 48,000		
5	Machine Hours	37,000	10,000	15,000		5,000	7,000		
5A	Labour Hours	\$337,500	\$100,000	\$125,000		\$ 62,500	\$ 50,000		
Factory Overhead:									
Salaries and Wages—									
6	Superintendent	\$ 6,000							F
7	Factory Manager	4,500							F
8	Foremen (4)	7,600	\$ 1,900	\$ 1,900		\$ 1,900	\$ 1,900		F
9	Timekeepers (3)	5,400	1,800	1,800		900	900		F
10	Sweepers, Watchmen, etc.	4,800							V
11	Other Indirect Wages	10,000							V
12	Proration of General	25,300	7,590	7,380		5,270	5,060		
13	Total Indirect Labour	38,300	11,290	11,080		8,070	7,860		

A STAFF CONFERENCE REPORT

Maintenance:									
14	Buildings	1,800 (25)	450 (40)	720 (20)	360 (15)	270	V		
15	Machinery and Equipment	5,000 (30)	1,500 (50)	2,500 (10)	500 (10)	500	V		
16	Yards, Sidings, etc.	2,500	750	729	521	500	V		
17	Total Maintenance	9,300	2,700	3,949	1,381	1,270			
Depreciation.									
18	Buildings	7,500 (25)	1,875 (40)	3,000 (20)	1,500 (15)	1,125	F		
19	Machinery and Equipment	15,000 (30)	4,500 (50)	7,500 (10)	1,500 (10)	1,500	F		
20	Tools, Taps and Dies	6,000	1,800	3,000	600	600	F		
21	Total Depreciation	28,500	8,175	13,500	3,600	3,225	F		
General Expense:									
22	Expense Material and Supplies	15,000					V		
23	Experimental Expense	5,000					V		
24	Spoilage and Wastage	3,500					V		
25	Taxes	7,500 (25)	1,875 (40)	3,000 (20)	1,500 (15)	1,125	F		
26	Insurance	3,000 (25)	750 (50)	1,500 (15)	450 (10)	300	F		
27	Light, Heat and Power	9,000 (20)	1,800 (50)	4,500 (15)	1,350 (15)	1,350	V		
28	Bonuses	2,200					V		
29	Overtime	1,000					V		
30	Workmen's Compensation	5,600	1,650	1,600	1,180	1,170	V		
31	Miscellaneous	8,000					V		
32	Proration of General	34,700	10,410	10,122	7,228	6,940			
33	Total General	59,800	16,485	20,722	11,708	10,885			
34	Total Factory Expense	\$135,900	\$38,650	\$ 49,251	\$ 24,759	\$ 23,240			
Factory Budget									
Based on Production at 2,500 Normal Working Man Hours									
35	% Overhead to Direct Labour	90.6%	85.9%	112.6%	79.2%	77.5%			
36	Overhead Cost per Labour Hour .. (Cents)	40.27	38.65	39.40	39.61	46.48			
37	Overhead Cost per Machine Hour	\$3.67	\$3.86	\$3.28	\$4.95	\$4.75			

The method adopted should be used throughout the year without any change in standard rates being affected, unless unusual variations or other unforeseen circumstances arise that make a change necessary or desirable.

In passing, it may be pointed out that where auxiliary or service departments exist, the total costs thereof are prorated over the productive departments on some recognized basis. In other words these departments are first treated as costing units, the total expense being afterwards allocated as a single item.

Overall Overhead Method

Where it is not considered necessary to departmentalize expenses, the overall overhead rate can be arrived at by dividing the total direct labour into the total overhead, as for example: Total overhead as per chart (line no. 34) \$135,900; labour cost (line no. 1) \$150,000; overhead percentage to labour, 90.6 (line no. 35).

Overhead Variations

Periodically the following information should be compiled: (1) Comparison of standard overhead expenses with actual; (2) comparison of standard labour cost or hours with actual, with percentages to indicate the ratio of actual production to normal; (3) comparison of actual expenses with the standard overhead absorbed in production, that is, the actual labour cost or hours multiplied by the standard rates.

This data should be prepared for each department. It may be noted here that the difference between the actual overhead and the overhead absorbed is usually referred to as variation.

It is not our purpose to discuss variations at this time as they will be taken up later on in the proceedings.

In this presentation we have attempted to outline the principles used in determining overhead rates. We have the opportunity of clarifying any points on which doubt exists in the discussion which is to follow.

BY-PRODUCTS, JOINT PRODUCTS, WASTE AND SPOILAGE

By A. W. Bell, M.B.A. (Harvard)

THE problem facing the accountant in accounting for costs of by-products, joint products, waste and spoilage is one of apportionment. A description of what is meant by the words reveals this.

(a) By-products arise where the production of one or more major products is accompanied by one or more minor products. Thus in the meat packing industry, the production of dressed meat is accompanied by numerous minor products such as stock and poultry feed, fertilizer, soap, glue, etc., and in flour milling industry the production of high grade flour is accompanied by the production of offal and feed.

(b) Joint or multiple-product operations are those in which several products are produced, the production being in such proportions that no single product can be called the major product. The oil and lumber industries are good examples, where in the former the cost of crude oil is apportioned to the gasoline, fuel oil, kerosene, etc., and in the latter the cost of the logs (minus the amounts realized from the by-products) is apportioned among the various grades of lumber produced.

(c) Waste and spoilage are self-explanatory except for a slight distinction. Waste arises from the operation itself, as in the case of cutting counters and innersoles from a belly centre or in cutting shapes of leather for gloves. Spoilage on the other hand implies imperfect work, although in most types of work a certain percentage is unavoidable.

Waste and Spoilage

As the accounting for waste and spoilage is much the simplest of the three, it will be dealt with first, and but briefly. The proceeds from the sale of waste are usually either credited direct to miscellaneous income, or, if substantial, credited against the cost of the process from which they arose. In the case of spoiled or defective work, a transfer is usually made from the goods in process account to a separate account for the cost expended thereon to the date of becoming defective. The balance in this account, after being credited with the proceeds, if any, on the

sale of the scrap, is usually considered an overhead item and apportioned as such. A logical refinement is to consider as overhead only a normal or standard allowance for spoiled work and to consider any excess as a separate operating loss, for it is difficult to see how a large increase in defective work should be allowed to increase the value or costing of the final inventory. In some cases the total cost of any job or process may be divided by the total of the "good" product to arrive at a unit cost, and in this case the cost of spoiled work does not show as a separate cost. This is somewhat similar to the treatment of waste when it is substantial. An example of this would be found in the manufacture of bricks where the number of good bricks produced in a given process is divided into the total cost of that process to give a unit cost.

By-Products

There are three common methods used in accounting for by-products: (a) The first and simplest is to treat any proceeds from their sale as miscellaneous income. An improvement on this method is to make the credit to goods in process, thereby reducing the cost of the major product. (b) The second method would be to charge any costs of marketing or selling the by-products against the income received from their sale, and to credit the balance against the cost of the main product. Where this method is used any by-products unsold at the close of a financial period would be valued at market price less estimated costs of marketing. (c) The third principal method in use is to charge the by-product with any costs, direct or indirect, which can be assigned to it after the point of separation from the main product. Up to that point all costs are assigned to the main product. In this case the inventory value would be the sales price, minus all further expenses of manufacture and sale, and this amount is usually credited to the main product cost.

Which particular method should be used will depend on the circumstances of each case, but certainly, where the by-product undergoes further processing after being split from the main product, the costs incurred in such process should be kept separate so as to enable the management to balance the increase in cost against the increased market value obtainable by the additional processing.

Joint Products

Of the several methods of calculating joint costs, the most common is on the basis of selling prices—or selling prices less separable costs. In other words each joint product bears all costs which can be directly assigned it, and the remaining costs are divided on the theory that presumably value is put into the respective products in the same ratio in which value as expressed by selling price comes out. Thus in the lumber industry, the cost of the logs used plus the saw mill, planing mill and lumber yard costs is apportioned to the different grades of lumber in proportion to the total market value of the yields of each particular grade. Similarly the crude oil cost plus the refining costs can be allocated to the gasoline, kerosene and fuel oil.

There are few cases where the cost of raw materials is allocated to the several products on the basis of the weight, volume or chemical units in each. For instance some coke manufacturers prorate the costs to the coke, coal tar, benzol, etc., in proportion to the weight of the finished product per ton of coal. This method is simple but is not logical because it assumes that the cost of the coal is based on its weight rather than on its content.

In some cases no attempt is made to allocate the joint costs to the different products or services. The railways are a fine example of this, as it would be fruitless to try to apportion the costs of maintaining the ways and terminals to the passenger business and to the different types of freight.

No attempt will be made in this paper to go into further detail as to any of the bases of cost allocation mentioned. It is perhaps worthwhile, however, before concluding this short paper to point out the dual purpose of any such allocation. The first is to give figures for the financial statements, and it would of course be an auditing function to see that the basis of costing is reasonable. Thus in the case of a lumber concern with nothing but the highest grades of lumber on hand at the year end, there would perhaps be a legitimate objection to valuing this lumber on the basis of the average board foot cost of all the lumber produced. The second purpose is to provide figures which will be helpful in making administrative decisions with regard to the several products. It is in this sphere that the

accountant should remember always that any basis he chooses to assign joint costs to the products produced is arbitrary. The resultant costs are not absolute and he should be very careful not to convey the impression that they are. In fact it might be wise for him to make certain that all who use such cost figures realize that they contain a large element of arbitrariness.

PROFITS OR LOSSES ON UNCOMPLETED JOBS OR CONTRACTS

By R. H. Ring

THERE is seemingly a great variety of opinion as to the moment when profit or income is "realized" from a business transaction. It is argued by some textbook writers that theoretically profit is realized as soon as a binding contract is entered into, but that practically it is undesirable to take credit for any profit on a sales transaction until the property in the goods sold (and hence the risk) has passed to the buyer. Other writers contend that profit is realized when the seller has executed his part of the contract, and not before.

Broadly speaking, in a sales transaction the seller performs his part by acquiring or manufacturing the goods, earmarking them for the particular contract, shipping them to the purchaser and notifying the purchaser of the act of shipment. Completion of performance by the seller will, in most cases, usually synchronize with the passing of the risk in the goods. Sound accounting demands that in ordinary circumstances no profit can be taken on any transaction until the cost of performing that transaction has been definitely determined.

Where long term contracts are undertaken it is frequently desirable that some accrual of profit should be reflected in the books before the completion of the contracts.

One method of arriving at the accrued profit may be employed when the contract is substantially completed. This method is to add to the total costs as at the end of the fiscal period the estimated costs of completion. From this information it is possible to determine with reasonable accuracy the final profit on the contract. The ratio of progress billings to the total contract price is then applied to

the total profit in order to arrive at the profit applicable to the period under review. From this amount it would seem advisable to make a deduction for contingencies.

A second method may be used where the same type of contract has been carried out over a long period and where reliable information thereon has been compiled. Estimates based on past experience are prepared for the cost of the contract and the expected profit percentage ascertained. This profit percentage is then applied in costing progress estimates, although it is usual and advisable that a portion of the estimated profit should be held back until completion of the contract.

Where the type of contract is such that there is a considerable element of risk to the contractor, no profit should be accrued before completion.

It is suggested that in all cases where it would appear that a loss will be sustained on the contract, the whole of such loss should be reserved for in the period under review, notwithstanding that the contract may be incomplete at the date of the balance sheet. It is not the intention at this time to go into details as to the various methods of ascertaining whether losses will be sustained on uncompleted jobs, but in examining uncompleted contracts it is essential that due consideration should be given to this problem.

Consideration should be given where accrued profit is taken up as to the advisability of indicating this fact by suitable wording on the financial statements.

War Contracts

In any consideration of accrued profit on war contracts it is essential that the following factors should be taken into account: (1) Costs as shown by the contractors' costs records may contain items which are not allowable under M. & S. 433; (2) the general limitations of profits under government regulations must be given due recognition; (3) the status of deliveries against contract quantities should be examined in order to determine whether such deliveries have been finally accepted.

Instalment Sales

There seems to be a difference of opinion as to the point of time at which the trading profit is realized on an instalment sale. Roughly speaking there are two divergent

practices: One takes credit for the whole of the profit at the moment the contract is made, the other takes credit for profit only as cash is paid. The first practice, which Montgomery states "is probably the more widely used", evidently reasons that the total risk of loss on an installment sale, like that on any sale, should be protected by creation at the date of the sale of a bad debt reserve proportionate to the sale and risk. However, where this method is used for recording profit on the books and in financial reports, it would be necessary to make parallel use of the second method in order to compute income for tax purposes.

Users of the second method, namely, of taking credit for profit only as cash payments are received, write off to profits the proportion of profit that the cash payment represents. Opponents of this method might properly ask the basis for assuming any correlation between the amount of a periodic cash payment and the realization of a profit. In the United States, however, the internal revenue department expressly sanctions its use for the computation of taxable income but this action is not sanctioned by the Dominion tax authorities. It would, therefore, seem that, depending upon circumstances, either method could be used.

General

Summing up, it would seem that there can be no hard and fast rule for the taking into income of accrued profits on uncompleted jobs or contracts. Each contract with its particular problems calls for individual study and thought. It would, however, seem strongly advisable that, if profits are taken into income, they should be conservatively computed and have due regard for contingencies and possible adjustments.

CIRCUMSTANCES UNDER WHICH A TAXPAYER IS ELIGIBLE TO FILE A STANDARD PROFITS CLAIM

By H. B. Watts, C.A.

IN this paper I shall deal with the circumstances under which a taxpayer has the right to appeal to the Board of Referees under the Excess Profits Tax Act for the establishment of standard profits. This right is the same

for a sole proprietor or the partners of a business as for a corporation.

I assume you are all familiar with the definitions of "board of referees", "capital employed", "standard period" and "standard profits", etc., as defined in section 2 of the act, and require no comment from me.

I might mention that the minister of national revenue has appointed a "committee of review" consisting of three members whose duty it is to examine all claims submitted for reference to the board of referees. The committee acts for the minister and decides whether there is justification for a standard profits claim and whether it can be dealt with by the minister or has to be referred to the board.

If you refer to section 4 of the act, you will note that claims for adjustment of standard profits such as differences in fiscal periods, changes in capital arising in the taxation year, and the acquisition of a business after January 1, 1938 which continues to be operated as a going concern by the purchaser in substantially the same manner as that of the vendor, are distinct from claims under section 5 of the act, and such claims should be made on the regular excess profits tax return. These claims cannot be referred to the board of referees but are dealt with by the minister of national revenue in the ordinary way.

Under section 5 of the Excess Profits Tax Act there are three captions under which a taxpayer may become eligible to submit to the minister of national revenue a standard profits claim (S. P. 1 and Questionnaire) for reference to the board of referees to determine the standard profits in the standard period. These captions are as follows: (1) "Depressed businesses"; (2) "new businesses"; (3) "business where a capital standard is inapplicable."

The decision whether a business is new or depressed rests primarily with the minister of national revenue. The claims from established businesses that are referred to the board are those where the minister is not satisfied that the business of the taxpayer was depressed or is not satisfied that the standard profits claimed are fair and reasonable.

Depressed Business

Under section 5, sub-section 1 of the act, if the taxpayer is convinced that his standard profits, ascertained in

the usual manner, or the minimum of \$5,000, are so low that it would not be just to determine his liability for excess profits taxes by reference thereto, he may compute his own standard profits at some amount which must not exceed 10% per annum on his "capital employed" at the beginning of the 1939 fiscal period. The claim then goes to the minister ("committee of review") who has two alternatives; he may agree with the computation of the taxpayer and assess the taxpayer or, if he is not satisfied that the standard profits as computed by the taxpayer are fair and reasonable, he may direct that the standard profits be determined by the board of referees.

It is my understanding that, with few exceptions, the board considers that any business which did not earn 5% on its capital employed during the standard period was depressed. There may be certain types of businesses which never have earned 5% upon their capital. In such cases the board is given power to leave the taxpayer with his own average yearly profits.

The awards by the board for standard profits claims coming under this caption appear to vary from 5 to 10% on the "capital employed" depending on the class and nature of the business.

Claims for Standard Profits of New Businesses

Under sub-section two of section 5 of the act, the following taxpayers are eligible to make applications to have their standard profits established by the board of referees, and the minister shall direct the board to establish these at the rate of return earned by taxpayers in similar circumstances engaged in the same or an analogous class of business in the standard period, namely: (1) A taxpayer who commenced business in the 1938 calendar year; (2) a taxpayer who commenced business after January 1, 1939; (3) a taxpayer who has increased his capital to the extent of $33\frac{1}{3}\%$ of the capital employed at the beginning of the 1939 fiscal period or at the beginning of the year next preceding the taxation period, may apply to be treated as a new business.

I understand that the limitation of 10% on capital employed does not apply to new companies.

Where a Capital Standard is not Applicable

Claims under this caption are permitted by sub-section

three of section 5 of the act, and the minister shall direct that the standard profits be ascertained by the board of referees. That sub-section was added during the 1941 session of parliament to enable the board to award a standard profit where a standard profit limited to a certain return upon capital would not be fair. In determining conditions for eligibility under section 5 (3) the board has insisted that lowness of capital is a primary requirement. The following classes of companies can be dealt with under this section, namely:

(1) Companies carrying on a business of a personal nature where capital is not an important factor, such as fire insurance, brokers, real estate agents, and other service types of business where no plant is necessary in order to carry on business nor any considered amount of working capital is required. In businesses of that kind to limit the standard profit to 10% of the capital would not be fair. In such cases the board considers the earning power of such taxpayers in their profitable period as compared with the standard period.

(2) Companies, the capital of which through losses has become abnormally impaired, so that the limitation of 10% upon the actual capital left would be far below the actual earning power of the company.

These are companies which have no equity capital, their liabilities together with the depreciation as calculated by the income tax department exceed their assets. In such cases the board bases its award on the earning power of the taxpayer in the profitable period as compared with the standard period.

(3) Companies of which the capital employed due to extraordinary circumstances is abnormally low. Where capital is abnormally low, one test which may be applied is to compare the capital employed with that of other companies engaged in the same kind of business. If the ratio of capital to the gross sales or turnover in the case of the applicant is substantially less than that of others engaged in the same business, this may be considered adequate to substantiate the claim that the capital is abnormally low.

Section 5, Sub-Section 4 of the Act

An award by the board of standard profits is not operative until approved by the minister, whereupon it becomes

final and conclusive. However, until such time as the award is approved by the minister, the taxpayer, if not satisfied with the award, has the right under section 5 (3) of the act, to apply to the treasury board to determine the standard profits and its decision is *final*.

We have been asked whether the following items may be included as assets or liabilities in computing "capital employed" under the first schedule of the act:

Question (1) Unamortized reorganization expenses. The answer to this question is that the amount must be excluded from the assets. The income tax department has always followed the policy of disallowing as a deduction for income tax purposes any charges to profit and loss for bond discount and expense, organization or reorganization expense; it also does not recognize the unamortized balance of such items as an asset in computing "capital employed".

Question (2) Premium on funded debt redeemed. The answer again is that the unamortized premium would be excluded from the assets. If the funded debt which was redeemed had matured, the unamortized premium should be charged off to surplus account at the time of the redemption. Sometimes funded debt is redeemed before maturity and the redemption premium is written off over the remaining life of the issue redeemed. However, in such cases the amount should be excluded from the assets in computing "capital employed".

Question (3) Goodwill acquired for cash consideration. Question (4) Copyrights, patents and trade marks acquired for cash consideration. These items may be included in the assets at their cost price providing they were acquired for the operation of the business of the applicant.

Question (5) Reserve built up from redemption of funded debt at a discount. This amount should not be included in the liabilities and consequently forms part of the "capital employed".

POINTS FOR CONSIDERATION IN THE PREPARATION OF STANDARD PROFITS CLAIMS

By C. E. Swift, C.A.

MR. WATTS has told you of the circumstances under which a taxpayer, who feels that his standard profits as determined under section 4 of the act, are so low that

excessive taxation will arise, has the right to request that standard profits of a larger amount be established. The purpose of this paper is to review some of the points to be included in the taxpayer's request.

This request is made by filing with the inspector of income tax a brief giving the taxpayer's reasons for requesting higher standard profits, accompanied by the information required by the income tax department on form "S.P.1 and Questionnaire", and a statement of capital employed determined in accordance with the first schedule of the act as at the beginning of each fiscal period in the standard period. In addition to these forms, the tax department has issued instructions (known as S.P.1 instructions) stating the information which it will require.

The answers to the questions on these forms give a complete picture in regard to the purchase of assets and the basis of their valuation in the accounts of the taxpayer, the taxable profits for as long a period as is necessary to prove that the profits of the standard period were depressed, sales volume, and the ratio of taxable profits to capital employed.

As "capital employed" is determined on the basis of the values admitted by the income tax department for the fixed assets and the amount of depreciation accumulated by the tax department thereon, it is advisable to agree the amounts used in determining capital employed with the records of the tax department.

It will be found in many cases that a great deal of work is required to answer some of the questions concerning the acquisition of assets, such as fixed assets and intangible assets and the consideration given therefor. This applies particularly to companies who have purchased their present plant and business from other companies at different times.

You will have noticed from the remarks of Mr. Watts that in all requests for an "increase" in the standard profit, one of the following two conditions must be proved: (a) That the business of the taxpayer was depressed during the standard period; or, (b) that the taxpayer was not in business prior to 1st January 1938, or has increased his capital to the extent of 33 1/3% of the capital employed at the beginning of the 1939 fiscal period, or at the beginning

of the year next preceding the taxation period (new businesses).

It therefore follows that the first point to be determined is the basis of making the application (depressed business or new business). Having made this determination, there is no set of rules which may be followed in the preparation of the brief. The Honourable Mr. Justice Harrison, chairman of the board of referees, has told us that the board had a large number of statistical studies made of the profits behaviour and earnings rates in various industries, in the hope that they might produce some helpful conclusions. The result of these studies was to show that there is no simple test for depression, and that the earnings rate of various businesses within the same industry is not comparable.

When it has been determined that the business of the taxpayer was depressed during the standard period, the following are some of the points which should be looked for and included in the brief, if they contribute to the depressed results for the standard period:

- (a) Extent to which operating capacity of the plant was used.
- (b) Analysis of sales into various lines of goods sold.
- (c) Determination of profit made on each line of goods sold.
- (d) Trend of costs.
- (e) Reasons for annual fluctuation in quantity of goods sold.
- (f) Reasons for decline in selling prices.
- (g) Effect of changes in management.
- (h) Effect of changes in capital structure. As a result of refunding bonds during the standard period, such period may have received the benefit of a lower interest charge and the elimination of foreign exchange on the bond interest for part of the period only.

Whenever it is possible to do so, it would seem desirable to prepare a table showing that if certain extraordinary conditions had not existed during the standard period, the taxable profits would have been approximately the same as higher profits in prior periods.

When a taxpayer is of the opinion that during the standard period his business was depressed when compared

with other businesses of the same class, it is advisable to obtain the capital employed and profit figures of the competitors in as much detail as possible, and to prepare statements comparing the figures with those of the taxpayer. In this connection Mr. Justice Harrison had the following to say: "The act suggests a comparative test and recourse to the earnings of competitors as a basis for judgment. In this connection the board has more than one alternative. The test need not necessarily be whether the applicant company earned the same rate on capital as its competitors. The more accurate test would be as to whether the applicant's position relative to his competitors in the matter of earnings over a period of years had deteriorated in the standard period."

The following facts should determine if the taxpayer can request to have standard profits determined as a new business.

(a) Actual date of commencing business subsequent to 1st January 1938. The taxpayer may have been in business for many years prior to 1st January 1938, but subsequent to that date the nature of his business may have changed. For instance, a retailer may have commenced to manufacture the goods he sells.

(b) An increase in capital employed of 33 1/3% will not be difficult to determine. In the case of a corporation, this increase must be accompanied by an equivalent increase in capital stock.

The next point to consider in preparing the brief is the amount of standard profit to be requested. The following are the methods of arriving at this amount:

Depressed Business — Capital Standard Applicable —
The act states that the board of referees may award to a taxpayer whose profits were depressed during the standard period, a standard profit equal to not less than 5% and not more than 10% of the amount of capital employed at the beginning of the last fiscal period in the standard period.

The taxpayer should claim the return he experienced in his most profitable period but not exceeding the maximum of 10% which the board may award. Schedules supporting the percentage claimed probably will have been prepared in providing the information requested in the various forms

for the tax department, and in proving the profits of the standard period were depressed.

In cases where the taxpayer has no satisfactory profit period, available information of competitors should be obtained and studied. When sufficient information cannot be obtained about the business of competitors, or it appears that the business of the competitors was depressed, it would seem that the taxpayer should request 10% of capital employed.

Depressed Businesses and New Businesses—Capital Standard Inapplicable—There are certain types of taxpayers to whom capital is (1) not an important factor; (2) abnormally impaired through losses; (3) abnormally low, and it would therefore not be just to determine their standard profits as a ratio of capital employed.

In such circumstances, the taxpayer should request that his standard profit be determined at a stated amount. This amount can be ascertained by a review of past earnings and, in the case of a new business, by obtaining figures of taxpayers in a similar type of business.

There is no limit to the amount or rate which may be awarded to taxpayers qualifying under this section, so the board is reluctant to deal with established businesses under the "low capital" provisions of subsection 3 of section 5 of the act. Before such claims will be considered by the board, ample proof must be given that the capital is low and Mr. Justice Harrison suggests that one method of proof is a comparison of the taxpayer's sales and capital with those of a competitor.

In conclusion I would like to bring to your attention the four types of claims which the Honourable Mr. Justice Harrison, chairman of the board of referees, stated were of no relevance in ascertaining standard profits under the act.

1. The claim to recoup out of profits the amounts necessary to compensate for past lean years and possible future lean years. (The board does have regard to the fact that some types of business are extra hazardous and may be classed as "feast and famine" businesses.)

2. The claim that certain types of business are entitled to a certain rate of return regardless of past earning experience.

ANNUAL MEETING PROGRAMME

3. The claim for increased standard profits because heavy borrowings or heavy inventories make it difficult to raise money to pay taxes.

4. The claim to have sufficient profit, after taxes, to pay fixed or customary dividends, or debt repayment obligations.

ANNUAL MEETING PROGRAMME

Following is the draft programme for the annual meeting of The Dominion Association of Chartered Accountants in Saint John, New Brunswick, in August.

Monday, 21st August

- 10.00 A.M.—Executive Committee
- 2.30 P.M.—Council
- 7.30 P.M.—Education and Examinations Committee

Tuesday, 22nd August

- 9.00 A.M.—Registration
- 10.00 A.M.—Council (continued)
- 12.15 P.M.—Dominion President's Luncheon for Dominion Council
- 2.30 P.M.—General Session
 - Address of Welcome
 - President's Report
 - Address by President of American Institute
 - General Business
- 9.00 P.M.—Informal Reception to Members and Ladies

Wednesday, 23rd August

- 9.00 A.M.—Registration (continued)
- 9.30 A.M.—General Session (Presentation of Financial Statements)
- 12.15 P.M.—Luncheon for Members, Ladies and Guests
- 2.30 P.M.—General Session (Taxation)
- 5.30 P.M.—Council (final meeting)
- 7.00 P.M.—Dinner-Dance for Members and their Ladies (dress informal)

The Circulation of Money

By W. A. McKague, M.A.

(The fourth of a series of articles on Money)

MONEY has this peculiarity—it is spent, but not consumed. Other forms of wealth are either consumers' goods, which from the time they reach their final purchaser are in process of consumption, or else they are productive goods, which from the time they go into service suffer a persistent depreciation. Change in ownership of goods which are in process of consumption or in service of production is the exception rather than the rule. Any value which may remain when they are discarded is mere scrap.

But the money which you spend goes to someone else so that he in turn may spend it. To the individual, money is a pool from which certain units are being withdrawn while others are from time to time added. To the nation, money is a circulating pool, divided among the people, and providing the means by which they settle all their other transactions. Coins suffer a very gradual loss through abrasion, which must be made good by the minting authority out of its profits. The paper note is less durable, some of the European varieties indeed being replaced as soon as they return to the bank, but British one pound notes, and United States and Canadian notes of all denominations, are intended to stand a great deal of handling. A very small proportion of money disappears through fire or other loss; in the case of metal, that is a loss of material wealth; in the case of notes, it is merely the holder's loss and the issuer's gain. You may handle gold or silver that was launched on its monetary career in the time of Caesar, while paper money of fifty years ago comes to light from time to time. Jewels tend to endure throughout the ages, but not without some loss through abrasion in use, and

REPRINTS AVAILABLE SHORTLY

The series of five articles which commenced in our April issue and conclude with the two instalments in this issue, will be available about 15th July in a separate pamphlet entitled "Money" at 25 cents per copy postpaid.

contraction in size through re-cutting to meet changing styles, while the organic pearl suffers an actual physical decline, and the unlucky opal is liable to disintegration or even explosion through changes in temperature or other physical conditions.

National Boundaries

When hard money circulated generally, it was no respecter of international boundaries, because, unless debased, it was worth its metal anywhere. While governments did not tolerate rivals in the making of coin, they had no objection to its being melted down, either within or without their own boundaries. However, when other things were equal, coins tended to remain in use within the jurisdiction for which they were made. Fiat paper money, on the other hand, has no intrinsic value, and circulates only among people who are deprived of a metal medium. Outside of that jurisdiction it is worth only what may be obtained for it in other currencies in the exchange markets. The unusual regard enjoyed today by the United States dollar is not so much due to its own merits as to the deplorable state of currencies and foreign exchange conditions throughout the world.

Some years ago there was a furore of discussion over the point that all the debts of the world exceeded all the gold in the world, the argument being that the former therefore could not be paid. If they all fell due on the same date, of course they could not be paid in metal. But they could have been paid in certificates of deposit, and the wider the maturities were spread the greater was the practicability. An individual may have a debt of \$1,000 and yet be fully solvent, through possession of other assets and earning power. When the due date arrives, he should have converted enough to gold, or to whatever is the legal tender, to liquidate it. In Canada, which has never held more than about \$200 millions in gold, the Dominion government alone has a debt of several billions, and for a single maturity of say \$100 millions or more a considerable accumulation is necessary. These, however, are all details incidental to the use of money as that part of the wealth used for settlement of transactions, and not as wealth itself, nor as a fixed collateral for debt. It is officially computed that in 1939 cash and cheque payments in Canada

totalled \$39,595 millions. Yet in that year only \$251 million of money was in circulation, and the amount on deposit in the banks was only \$2,586 millions, or a total of \$2,837 millions of current funds. Obviously, the same money and credit balances were used over and over again, the velocity of money being computed at 16 times and that of bank deposits at $13\frac{3}{4}$ times per annum. If the same money and credit balances can be used thus frequently in a year, to liquidate debts of many times their volume, then the world's gold stock can similarly be used to liquidate many times its volume.

HOW MUCH MONEY?

(The fifth and last of a series of articles on Money)

THE previous articles have brought us to the following conclusions:

1. That money, to the individual, is a utility of limited service, and useless beyond its limit.
2. That to the nation, which is composed of individuals and of the institutions which they conduct, there likewise is a limit to the usefulness and to the quantity of money.
3. That money, for the time being, is deprived of intrinsic value and specific metal backing, and consequently has no dependable relation to prices of precious metals.
4. That through its circulation, the same pool of money furnishes the means for the settlement of many times its amount in transactions during a year.

Through abandonment of gold redemption, money has slipped its anchor, having surrendered the judgment of the world concerning the value of a precious metal, and being now dependent upon the skill of seamanship in the face of varying winds and currents. It can not be said that the experience of mankind under gold or other metallic standards was always happy, but no more has it been continually blessed under Christianity, nor has the service offered by the steam railway always been safe and reliable, nor the meat of the ox well-flavored. So long as we used coin or redeemable notes, there was always some stew in the pot. It probably was a mistake to have ever taken a receipt or note in place of the gold, and the formulae of gold reserves built up by the bankers and the governments

have been all for nought, at the behest of the governments themselves. For now we are launched and sailing in a sea of paper money.

Money Management

And while it is true that metal standards never worked to perfection, it at the same time can be argued that purely paper money can be controlled in such a way as to be both safe and sound, and at the same time superior, in respect to such human objectives as stability and justice. For it is almost universally admitted that a good money should keep prices stable, thus permitting of sound planning, and avoiding unearned profits on the one hand and unmerited losses on the other. A paper money, in conjunction with other phases of central banking, may do this, if human judgment is kept free from both error and partisanship. When one realizes that the function of government is thousands of years old, and that the great nations of the world are today engaged in a life and death struggle over the principles of government, one is entitled to be pessimistic concerning the prospects of money as an instrument of the state.

The only kind of money which is intrinsically sound, protecting both the people and the nation against loss and also providing the greatest measure of price stability, is "hard" money, with gold or other precious metal, or combination of precious metal, as its content, and including paper money so long as this is always redeemable in the metal, and backed by enough of the metal to ensure redemption. A fiat paper money, such as we have at present, furnishes none of these safeguards, but it may serve as a suitable substitute for sound money so long as it is not allowed to outrun the function of providing a utility at minimum cost. One of the features inherent in such a paper money, even when controlled in this way, is that it opens the door to experiments involving the monetary system, which would be out of the question in a hard money system. All plans for expanding the issue of money beyond what people want to hold, involve a levy or special tax on one or more classes of people, for the benefit of one or more other classes. They accordingly introduce questions of economics and socialism which are beyond the legitimate field of money.

As a utility, money can be provided at a minimum of cost. The fact that paper money can be furnished at nominal cost is no reason for forcing more of it into people's hands than they want. The question of "how much money" which would seem to have solved itself automatically, on the basis of demand, has become a political issue because certain groups, finding our money free of backing and therefore of practical limitations, see in it an agency for economic and social reform.

This movement is stimulated by the rarefied air of public finance in which we now live. Public debt in nearly every country has become a burden on every class, causing some groups to seek redress at the expense of others. In Canada the public debt is now about 40 per cent of the national wealth, its interest charges absorbing nearly ten per cent of the normal income and, when other costs of government, apart from the war, are added, a total of about 25 per cent of the people's incomes is required. A moderate variation in the issue of costless money, which as we have seen is accorded only a one per cent status in the average individual's wealth, would not make any appreciable dent on the debt problem. But as the problem expands, so also do the ambitions of the reform proposals.

Inflation Proposals

Such proposals usually have the dual intent of first enabling the government to borrow at nominal or low cost, and second of effecting economic and social reform. The demands of the citizen, as a purchaser and user of money, receive slight consideration, for it is generally assumed that whatever extra he will get, will be at no cost to him, and therefore that he should want it, which does not necessarily follow. We would each and all welcome a gain in wealth. But without such a gain, we resist rather than request an increase in money. A worthwhile increase in the issue of mere money, as distinct from real wealth, therefore would become possible only through the imposition upon the individual of some formula of allocation of his wealth, or through some controls which would make the holding of money relatively more attractive than it is today.

Proposals involving the monetary system nearly all range themselves in one or other of the following three

classes: (1) Unusual issues of ordinary money; (2) issues of restricted or deferred "money"; (3) issues of paper related to output or national wealth.

(1) **Unusual issues of ordinary money.** A host of plans can be embraced under this head. While who gets the money would be an important social issue, from the purely monetary viewpoint it does not matter much whether the recipients are to be old people, or young people, or unemployed, or everyone. The whole idea is that, if a lot of additional cash is put out all at once, the entire flow of business will be stimulated, and part at least of the extra money will remain in circulation. This school of thought was somewhat discredited by the failure of repeated doses or injections of public money in the United States and many other countries during the depression years. The money went from the citizen to the merchant, all right. From the merchant it went to the bank, and from the bank it went right back to the public treasury, which had to give value for its redemption. Then, to cover the expenditure, the government had to borrow from the public, and to impose new taxes for the interest, all of which wiped out what little benefit had been derived from the temporary spurt of buying.

(2) **Issues of restricted or deferred "money".** These include non-interest bearing bonds. If these issues are made as a gift or bonus, the net result probably will be their redemption at the general expense. If substituted for legal tender in payment of debt or other obligations, they amount to a special tax on the recipients in so far as the special money falls short of ordinary money in convertibility and general usefulness. In a recent public discussion, one man who urged such issues was asked if he was willing to take such money in payment for his own products. He answered "Of course not, because I have to keep my capital working", and, on being pressed further, the banks were the only parties he could think of as being able to hold such money without hardship. Such schemes contemplate some group other than the proposers, and usually it is the bankers or bondholders, to hold the frozen money. It is a case of who will bell the cat.

(3) **Issues of paper related to output or national wealth.** If every one could be assigned a year's quota of service,

covering labor, investment capital and other items as at present, then presumably we could start off by issuing to him that amount of money once a year. If every one in Canada were paid at once, the issue at the present rate would be about \$8,000 millions. The state in effect would be buying up the year's output. Each citizen would then commence his spending. Since all the buying would have to be from the state, the money would have to be paid back to it. At the end of the year, even if the proportions of goods and the price schedules had proved exactly correct, all of the goods would be out and all of the money in, or else a little of the money would have been "saved" by the people and goods to correspond should be held by the state. But how would the result differ, from either the individual or the national viewpoint, from the present practice of paying the same wages by instalments, and transacting all the business by continual circulation of the same pool of money? Indeed, the suggested plan would require a super-human intelligence and involve an unnatural rigidity, as compared with the fluidity of present practice. There is no point in using more money than is needed for the job, even if it is only costless paper money.

The issue of paper to correspond to all the wealth of the nation would, in order to have any meaning, have to supplant all present title to property, and therefore would be undertaking the job of redistribution of wealth from a capital point of view. Any proposal of this kind is a lightly concealed design for bringing about state socialism.

Social Objectives

It is not the purpose of these articles to discuss the problems of economic or social justice. Various kinds of proposals have been outlined not because they are essentially monetary, but because they propose to use the monetary system as a means to an end. They are still far from adoption, chiefly because money authority is vested in the federal governments in both Canada and the United States, and the movements have not yet been widespread enough to dictate federal policy. Nevertheless certain of the recovery or war measures undertaken in both countries did involve some attempts to expand note issues. When such action is proposed, it is important that we keep in mind,

what is money, and what is prostitution of money for other purposes.

This writer does not for a minute deny that the monetary system, as now divorced from metal backing, is susceptible to manipulation for purposes of economic and social change. Such change may be for better or for worse. Indeed, almost any important change in the economic balance brings advantage to some and injury to others, though the aggregate result is harder to appraise. But it is submitted that, since immediate negotiability is a requisite of money, anything which is restricted in this respect is not money. Under such conditions people would have to seek something that is immediately negotiable, whether it be surreptitious stores of U.S. currency (assuming that such money should escape a similar blight) or old gold, or silver, or wheat certificates. For the status of money, popular acceptance is a more important condition than is a mere government decree. Accordingly, whatever might be issued in the name of money would, through its own lack of negotiability, not be real money, but merely an instrument of economic and social reform. In this way the author evades the task of debating the problem of such reform, which is so vast that it could not be encompassed in any degree within these pages, and which is not an integral part of the study of money.

There remain just a few questions which, while likewise outside the scope of mere money, involve some consideration of the monetary system.

The Place of the Chartered Banks

One of these is the future function of the banks. As we have noted, the chartered banks of Canada have been divested of the power of issue, so that they can not again be accused of making profits out of this authority. They still deal in credit. But they do not in any sense "issue" credit. They receive deposits. They make loans, and in making loans they often do create deposits, in so far as the amount of the loan is not fully cashed at once, nor perhaps at any one time, by the customer. But it is out of the difference between interest charged on loans, and interest paid on deposits, that the banks make most of their profits. These profits may be curtailed in the future, because the chartered banks have become subordinate to the central

Bank of Canada, which has taken over some of the more profitable functions.

The Debt Problem

While the debt problem is outside the direct scope of this study, and quite beyond the curative power of money as a utility, it is one of the objectives of the plans which embrace experiment with the monetary system. We will end this war with a public debt of at least ten billion dollars, or about 40 per cent of the national wealth. The wealth is still here, and so far as most of the public issues are concerned no part of it is directly pledged, but for the payment of interest, and of any principal that may be retired, there is a constant drain on the earnings of productive wealth or capital, as well as on the earnings of labor. Through this process, part of the fruits of both investment and labor is transferred firstly to the governments and secondly to the creditors. The bond holders have in effect a share in the output, even though this share is not all net, since they themselves have to meet part of the upkeep, at rates rising to as high as 90 per cent of the largest individual incomes. So long as this situation holds, there is a high degree of socialization of wealth and income.

If a solution were attempted, it would no doubt be along one of the following lines: First, a partial or complete repudiation of the debt, which of course would be a confiscation of part or all of the savings which have been turned over to the governments for bonds, savings certificates, annuities and pensions. Second, a capital levy which, instead of imposing all the loss on these lenders, would attempt to spread it over all owners of wealth. And third, a depreciation of money, which would reduce the commodity purchasing power of the holders of the public debt and also of the creditors under all other debt contracts.

The Gold Stock

What is the future of the huge gold stock accumulated by the United States? Or, to put the question another way, what is the future of money, in the light of the concentration of gold in the United States? The total in that country is about 630 million ounces, out of a world total of about 800 million ounces of monetary gold. In dollars at 35 to

the ounce, these represent some \$22 billions and \$28 billions respectively. There consequently is far more gold in the United States than can be used by that nation as money, to say nothing of the enormous stock of silver that is also being accumulated.

No positive answer can be given, nor is any definite plan known to exist in official or other quarters. But this mountain of precious metal does put the United States in the way of being the world's banker to a much wider degree than it is even now. The world's gold is enough to supply everyone in the world with an average of \$14 of the pure metal, which is far above any average that has yet been attained. If circulation were doubled, through use of a fifty per cent alloy or through the issue of notes with a 50 per cent gold backing, it could provide money at the rate of \$28 per person which, as we have seen from the United States and Canadian figures, is plenty for the unusually high standard of living that prevails in these two countries.

So long as the United States controls three-fourths of this total, it is in a position to open a bank on a sound basis in every country and commercial centre in the globe, and thereby to make possible the gradual redistribution of gold to every country and to every individual, a process which would be difficult enough in view of the low productive power of so many peoples, but it is not at all impracticable, and it certainly would involve slight hardships as compared with those demanded in the financing of the great wars with which peoples in all quarters of the globe are now afflicted.

TOO MUCH FOR A MATHEMATICIAN

An Associated Press despatch from Princeton, N.J., quotes Prof. Albert Einstein, world famous mathematician and wizard of the fourth dimension, as saying that he, like millions of ordinary Americans who were mulling through complex income tax forms, had to call in a tax expert to help him prepare for the March 15 deadline. Asked what his reaction was to the maze of income tax questions, Prof. Einstein replied: "This is a question too difficult for a mathematician. It should be asked of a philosopher."

Reserves For Income Tax

JUDGMENT was rendered by Mr. Justice Thorson, president of the Exchequer Court of Canada, on June 5th, 1944, allowing the appeal of Kenneth B. S. Robertson Limited from an assessment of the Minister of National Revenue. In substance it was held that a so-called "reserve for unearned commissions" was not a reserve at all but a segregation of amounts received which were not profits or gains from the business at the end of the fiscal period and therefore not taxable in the hands of the appellant.

Nature of Business

The appellant acted as representative for certain underwriting members of Lloyds of London, England, writing workmen's compensation, employers' liability and occupational disease insurance. It did not directly solicit insurance business but dealt exclusively with insurance brokers in the United States who acted for employers of labour there. When a policy contract was negotiated the appellant issued a temporary document until the final contract was issued from London.

Two types of contracts were issued, in one of which the underwriters indemnified the employer against all loss in excess of 70% of the employer's normal premium, and in the other type of contract in excess of 75% of the normal premium. The contract was really one of reinsurance whereby the employer looked after 70% or 75% of his losses himself and the underwriters insured him in respect of the balance. The premium payable was described as "normal premium" but this could not be ascertained until the end of the period of the contract inasmuch as it was ascertained by multiplying the entire remuneration earned by all employees during the whole period by the rates provided for the various operations in which the employees were engaged. In order to meet this difficulty the employer paid an "advance fee" based upon an estimate made by him as to what he thought his total payroll for the year would be. If the advance fee proved to be inadequate, an "additional fee" became payable by the employer. If the advance fee was excessive due to an over-estimate by the employer or cancellation of the contract prior to its expiry, or for any other reason, the underwriters became obligated to refund the excess to the employer. The amount of the

"advance fee" was not left entirely to the employer to fix. He was required to pay in any event a "minimum fee" which was defined as the minimum amount to be accepted and retained by the underwriters regardless of the earned fee developed after audit of payroll.

Practice Followed by Appellant

As the appellant received fees it immediately distributed them, whether they were advance fees, minimum fees, additional fees or earned fees. A portion of the fees went to the underwriters for reinsurance, a further portion to service organizations who serviced the risks, and the balance was used by the appellant to pay brokerage fees and its own remuneration. The appellant's remuneration was a fixed percentage of the total paid by the employer. If adjustments had to be made subsequently involving refunds to employers either because of cancellations or by reason of over-estimated payrolls, the persons who had shared in the distribution of the fees refunded to the appellant the excess amounts received by them. Thus as the appellant's remuneration was a fixed percentage of what the employer had to pay, it followed that when a refund became payable to an employer the appellant had to refund part of its own remuneration.

The appellant was incorporated in 1934 and in the first two fiscal periods ending August 31, 1935, and August 31, 1936, respectively, it disclosed all fees received by it during each fiscal year as income for that year. At the suggestion of its auditors it subsequently altered its practice and in each of the years ending in 1937, 1938 and 1939 it made provision in its books as liabilities for "reserve for unearned commissions." The amount set up for 1937 was \$3,000.00 and this was a guess. The amounts reserved for 1938 and 1939 were respectively \$5,631.00 and \$10,846.08. Such sums were arrived at by calculating the unearned amount in respect of all policies still in force at the end of the year and making a deduction for the unexpired portion for each. The learned judge agreed that this was sound accounting practice. The obvious intention was to allot to each of the fiscal years the proportion of fees that was applicable to such year in order to show the true income position of the appellant, but he pointed out that that did

not necessarily mean that the practice was permissible for income tax purposes.

Assessment

The appellant was additionally assessed in 1937 for the whole reserve of \$3,000.00, but for 1938 only for \$2,631.00 and for 1939 for \$5,215.08 as though the reserves had been cumulative. The judge found the evidence quite conclusive that such was not the case as each reserve was in respect of the particular year's operations.

Judgment

Mr. Justice Thorson considered section 6.1.(d) which provides that in computing the amount of profits or gains to be assessed a deduction shall not be allowed in respect of amounts transferred or credited to a reserve, contingent account or sinking fund, except such an amount for bad debts as the minister may allow, and except as otherwise provided in the Income War Tax Act. He made the observation that in order to come within the prohibitions there must have been a transfer or credit from profits or gains. In addition to bad debts the only reserves provided for in the act are reserves for depreciation and depletion. The only other case dealing with the section was *Western Vinegar Limited v. Minister of National Revenue* decided in 1938 by Mr. Justice Angers, in which he held that a reserve to cover losses on return of containers was not a reserve properly called. The loss was a certainty, the only uncertainty being as to the amount thereof. Mr. Justice Thorson found it difficult to reconcile the decision with authorities that apply the general rule that profits are to be taxed in the year in which they are received and losses borne in the year in which they are sustained.

The learned judge referred to English and United States decisions establishing that even apart from such a provision as section 6.1.(d) of the Income War Tax Act, a taxpayer cannot deduct from his income any amounts to meet contingent liabilities. He also held that the appellant was not entitled to distribute the amounts received by it as income during any fiscal year into amounts earned during such year and those that were not yet earned. The test of taxability in any year is not whether the taxpayer earned or became entitled to such income in that year, but whether he received it in such year. Decision on these points did

not, however, dispose of the appeal and the judge had to determine whether all of the amounts received by the appellant were received as income. He had to determine whether the appellant's right to the amounts received was absolute and under no restriction contractually or otherwise as to its disposition, use or enjoyment, or, to put it in another way, could an amount in a taxpayer's hands be regarded as an item of profit or gain from his business as long as he held it subject to specific and unfulfilled conditions and his right to retain it and apply it to his own use had not yet accrued and might never accrue? It was necessary to draw a distinction between the "minimum" and "additional" fees on the one hand and the "advance" fees on the other hand. The minimum fee could be retained by the underwriters regardless of what the earned fee might prove to be. It was therefore income, and if the reserves included any amounts in respect of percentages of minimum fees such amounts were not properly included.

The same holding applied to the additional fees because they were paid as the result of ascertained facts. The advance fee was paid to be held as a deposit with a right to the appellant to retain it to its own use only under specified circumstances which might or might not arise. The right of the appellant to distribute the advance fee except that portion which was a minimum fee, before it was known whether the underwriters might retain it or would have to refund it, was highly questionable, but if it could not be income to the underwriters no percentage of it could be income to the appellant. The so-called reserve in so far as it consisted of percentages of advance fees excluding minimum fees therefrom, was not a reserve within the meaning of section 6.1.(d) but was rather a segregation of amounts received which were not yet profits or gains from the business of the appellant and therefore not taxable in its hands and might never become such. The appeal was allowed with costs.

The Business Men of the Navy

By Lieutenant (SB) Joseph Schull, R.C.N.V.R.

(The following is copy of a broadcast over C.B.C. stations on April 26, 1944, under the direction of Commander William Strange, Department of Naval Information, Ottawa.)

THIS is going to be a very short talk on the work done by those naval officers who wear white between the gold lace on the sleeves of their jackets. You may have heard them described as paymasters—a term which is about 75% inaccurate. A title more nearly correct, but not at all complete, is accountant officers. Some of these men are paymasters and many of them are accountants but they are also a good deal more. We haven't yet found time to adapt an exact term of reference; but actually the accountant branch officers, so called, are the business men of the Navy.

First of all, let's dispose of the more obvious of the jobs done by men of the accountant branch. They *do* look after all matters affecting pay and accounting for the navy. To put it in business language they attend to the accounting for a firm which has some eighty thousand employees and some seven hundred branch offices. Most of the "branch offices" are ships roaming the seas—which doesn't add any particular joy to the work of keeping their pay and accounts straight. When you consider, too, that this firm has increased considerably over a hundred times in size in the space of five years you may realize some of the difficulties involved in looking after its finances.

From the ranks of the accountant officers come the captains' secretaries for the ships and the shore establishments. In his capacity of secretary to the commanding officer of a ship, the accountant branch officer must be first of all an expert on naval law and procedure. The King's Regulations and Admiralty Instructions is a completely terrifying volume of some two thousand finely-printed pages. It is the naval Bible—the repository of wisdom accumulated by the British Admiralty down the years. The captain's secretary must know where in that mighty tome he may put his finger upon the exact regulation required by the captain in deciding a case or determining a method of procedure. He must be able to interpret any regulation. He must also be completely

familiar with any points upon which K.R. & A.I.—(as it is affectionately called)—may be revised to meet specific requirements of the Canadian Navy.

Next, the accountant branch looks after victualling and supply for the navy. All cooks, stewards, dietitians, and supply assistants are members of the accountant branch. Remember that figure of eighty thousand men—seven hundred ships. Think of the conditions and the places in which those men must be fed, clothed, furnished with the innumerable requirements of wartime seafaring. The accountant officers handle that job pretty well—there are no seamen better equipped, better clothed or better fed anywhere in the world than those of the Canadian Navy.

The work of improving our men's diet is something that goes on unceasingly. Samuel Pepys—whom you probably know as a whimsical diarist, but who was also one of the greatest secretaries the Admiralty ever had—proclaimed it as his belief that "Englishmen, and more especially seamen, love their bellies above anything else." While, perhaps, not subscribing wholly to this doctrine, we do feel that the importance of good food to men at sea can hardly be over-estimated, and providing it in abundance is one of our principal concerns.

Then there are the naval stores—which are more varied than those carried in a large hardware store—anything from a needle to an anchor—parts for wireless and other secret equipment. Both accountant officers and supply ratings must be familiar with all these stores and know the requirements of all classes of ships.

Not many accountant officers in our small-ship navy are lucky enough to get to sea. Most of them have tried. A collection of the various reasons advanced by restless white-stripers would be an inspiring testimony to the ingenuity of the human mind. And some of them may have better luck in the not too far distant future.

One thing at least may be said. Those ships whose establishment permits them to accommodate an accountant officer welcome him with open arms, because he is in miniature aboard ship what he is in general—throughout the whole administrative service of the Navy.

In addition to being the business man—the trouble shooter—the bearer of those necessary indispensable ad-

ministrative burdens—when “action stations” is sounded off in our larger warships and in some of the smaller ships the naval A.O.’s are usually to be found manning gunnery, torpedo or anti-submarine control positions—thus taking a more active part in the constant battle against the enemy.

Sometimes the accountant officer’s work may appear humdrum. But the long range results in terms of improved organization, streamlined procedure, better supply, service and meals all leading to better morale among the fighting ships are often exciting and provide that feeling of satisfaction that results only from a job well done.

INCOME TAX DEDUCTIONS

The following order in council (P.C. 104/2200) approving a minute of the Treasury Board was passed 28th March 1944:

The board recommend that the following regulations governing tax deductions at the source be established:

PART I

That employers be not required to make tax deductions at the source from the salary or wage paid to an employee who furnishes to the employer information on a form prescribed by the minister of national revenue declaring that the employee is—

(A) A person who, if fully employed for the balance of the calendar year at his present rate of pay, would not receive during such year total salary or wages of a sufficient amount to render him liable to income tax; or

(B) A housewife employed seasonally or temporarily for a total period during the calendar year not exceeding six months and who will not be in receipt of a total income during the calendar year in excess of \$660; or

(C) A student at a school or university employed only on seasonal or part time work or in a temporary capacity during spare time or the vacation period and who will not be in receipt of a total income during the calendar year in excess of \$660; or

(D) A male member of His Majesty’s Canadian forces on active service in Canada, whose service pay and allowances do not exceed \$1,600 per annum, employed on civilian work during his spare time or during military leave which has been granted for a period not exceeding four months and who will not be in receipt of a total income during the calendar year (excluding army pay and allowances) of a sufficient amount to render him liable to income tax; or

(E) A resident of the United States temporarily employed in Canada for a period not exceeding ninety days and whose earnings from employment in Canada during the calendar year will not exceed \$1,500.

PART II

That employers be not required to make tax deductions at the source from the salaries or wages paid to employees who satisfy the minister that they will not be in receipt of sufficient total income for the calendar year to be liable to income tax, notwithstanding that the salaries or wages they receive during a portion of such year are at rates which would otherwise be subject to tax deductions at the source.

Income Tax Questions In The House

SOME income tax questions asked in the House of Commons this session, with the answers supplied by the minister of national revenue, are printed below.

Expenses for Advertising, Etc. (February 24)

QUESTIONS:

1. To what extent are expenses for the maintenance of public relations counsel deductible from the income of persons or corporations, (a) in respect to public relations counsel employed by such persons or corporations; (b) in respect to contributions to independent public relations counsel?

2. To what extent are expenses for advertising of a political nature deductible from the income of persons or corporations before taxation thereof?

3. To what extent are expenses or contributions in respect to political parties deductible from income before taxation thereof?

ANSWERS:

1. (a) and (b) To the extent necessarily incurred to maintain and earn the income of the payor, along with other necessary expenses, but not to the extent that they are deemed to be in excess of what is reasonable or normal for the business carried on by the taxpayer.

2. Not at all.

3. Not at all.

Income Tax Assessments (February 28)

QUESTIONS:

1. Is there a quota system for income tax collections in each inspectorate, with competitions for prizes between inspectorates or individual civil servants?

2. Are salaries and promotions in the income tax branch dependent in any way on the amounts of tax which civil servants succeed in assessing against individual citizens or corporations, or both?

3. If such a system exists or has existed in the last ten years, at what dates did it start or stop?

ANSWERS:

1. No.

2. No.

3. Answered by Nos. 1 and 2.

Compulsory Savings (March 29)

QUESTIONS:

1. Has written acknowledgment of amount of compulsory savings standing to their credit been given taxpayers by the government?
2. If not, when will it do so?

ANSWERS:

1. Yes, already over 800,000 certificates of compulsory savings have been issued in connection with the 1942 income.
2. Answered by No. 1.

Income Tax Offices (April 27)

QUESTIONS:

1. How many income tax offices are there in Canada?
2. Where are they located?
3. How many employees are there in each of these offices?
4. How many employees are there in the main office in Ottawa?
5. What was the total salary of all these employees in 1943?
6. What was the total amount of income tax collected in 1943?

ANSWERS:

1. Nineteen district offices; six sub-offices.

2. and 3.:

Halifax	173
Charlottetown	27
Saint John	105
Quebec	157
Montreal	933
Ottawa	482
Kingston	39
Belleville	52
Toronto	800
Hamilton	476

Sub-offices of:

Brantford	5
Kitchener	6
St. Catharines	4
London	244

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Sub-offices of:	
Stratford	2
Windsor	5
Fort William	47
Winnipeg	305
Regina	91
Saskatoon	69
Calgary	120
Edmonton	75
Vancouver	512
Sub-office of:	
Victoria	12
Dawson	2
4. 382.	
5. Calendar year 1943—\$6,232,608.27.	
6. Fiscal year 1943-44—\$1,635,494,706.37.	

Arrears and Prosecutions (May 4)

QUESTIONS:

1. What are the arrears of income taxes uncollected for each of the years 1932 to 1942, both inclusive?
2. How many court or other legal actions have been taken by the income tax division looking towards the collection of arrears of income taxes since 1932?
3. What have been the results, (a) in amount of taxes collected; (b) in how many cases have such actions resulted in failure to collect; (c) in compromise of arrears, if any?
4. How many prosecutions for infractions of the Income Tax Act have been instituted during the past ten years ending March 31, 1943?
5. How many of such prosecutions have resulted in convictions, and how many in dismissals?

ANSWERS:

1. (a) Transferred to head office as uncollectible since the inception of the act to date\$ 2,467,368 29
The following statements (b), to (f) in response to question No. 1 are in respect of the accounts as at Mar. 31, 1943:
- (b) Outstanding more than five years and still under process of collection 1,017,129 34

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(c) Claims against members of the armed forces which are held in abeyance, pending their return.	436,778 54
(d) Bankruptcies not wound up as at the said date, subject to some further collection	174,797 40
(e) Untraceable taxpayers	217,004 30
(f) Uncollectible accounts not yet transferred from district office records	442,229 77
(g) Total of (a) to (f) inclusive ..	\$4,755,307 64
(h) Collections by the income tax division for all years up to and including the fiscal year ended Mar. 31, 1943	\$4,018,400,395 00

Percentage of (g) to (h)—approximately 1/10th of 1 per cent.

The information for the ten years and for each of the years mentioned is not available in the form requested, but the foregoing contains the information most proximate to the apparent intent of the question.

2. (a) Exchequer court actions—1,727.

(b) 5,903 through legal agents at various points throughout Canada, which agents have taken action in some cases in various local courts when the lawyers' letters demanding compliance with the law have failed to bring proper response.

(c) 29,287 actions by way of taxpayers' creditors being required to pay, not to the taxpayer, but to the crown, sometimes referred to as garnishee actions.

3. (a) (1) \$1,484,074.93 through Exchequer court action. (2) Amount unknown of collections through local legal agents—records not maintained. (3) \$1,278,567.57 through garnishee proceedings.

(b) (1) 480 through the Exchequer court. (2) Number through legal agents unknown—records not maintained. (3) Number through garnishee proceedings unknown, but believed to be nil—records not maintained.

(c) Compromises have arisen when other creditors of the debtor have compromised their claim or where it appears that compromise will collect more than legal action. A summary of such cases is not maintained.

The answer to paragraph (3) of (b) and to (c) above is believed to be, on the best evidence available, less than 100 in number.

4. 937.

5. (a) 214 convictions. (b) 723 were either dismissed or withdrawn on compliance with or satisfaction of the law, and upon paying our legal agent fees and the court costs incurred. The number dismissed is not kept separately from the number withdrawn. The record is the number of cases concluded. The number of cases dismissed is believed to be under 50.

Unusual Medical Expenses (May 15)

QUESTION:

Last week the minister of national revenue made a statement in Hamilton to the effect that by a recent ruling of the income tax department deductible allowances for unusual medical expenses provided by the Income Tax Act had been extended to apply to osteopaths and chiropractors, physiotherapists and others registered under any dominion or provincial legislation. Will the minister tell us if this was announced in the House of Commons; and also if chiroprodists come under this ruling?

ANSWER:

When I was in Hamilton I did make an announcement concerning a ruling that had been made under the Income War Tax Act as to those who are entitled to be included under the clause in the Income War Tax Act dealing with unusual medical expenses. The act provides that certain practitioners who are licensed in the provinces come within a certain class. The accounts of these people may be allowed as a medical expense. The ruling includes osteopaths and chiropractors if they are registered in their province and have a licence to practice in that province. I would not want to make a ruling with regard to all branches of the medical profession until details of their qualifications are put before me.

QUESTION:

Does it apply to Christian Science healers?

ANSWER:

As I have said, I would not want to answer that question without full details of their qualifications.

War Contracts Depreciation Board (May 18)

QUESTION:

What is the total of amounts granted by way of special depreciation pursuant to the recommendation of, or under the authority of, the war contracts depreciation board from the creation of the said board until December 31, 1942?

ANSWER:

Awarded 1939 to 31st December, 1942, \$73,409,045.70; written off to 31st December, 1942, \$60,479,138.26; to be written off 1943 to 1949, \$12,929,907.44.

Income Tax, 1942—Deferred Tax (June 8)

QUESTION:

What is the total amount of money received to date under item 36, general income tax T1 form for the year 1942?

ANSWER:

The total amount of deferred tax received as of May 31, 1944, under item 36, T.1 general 1942 is \$4,743,111.

POSTPONEMENT OF 1943 INCOME TAX BALANCES

The following order in council (P.C. 115/3735) approving a minute of the Treasury Board was passed 12th April 1944. It slightly changes the wording of the previous order in council which was reported in our June issue.

The board recommend, under the War Measures Act, that order in council P.C. 98/2595 of April 12, 1944, be repealed and in lieu thereof the following order be substituted, namely:

"Any individual or estate taxable as such shall not be required to pay income tax or interest in respect of that portion of the tax based on the income of the year 1943 that was or should have been paid in accordance with section 48 of the Income War Tax Act, but such tax shall be payable on the 31st of August, 1944, together with interest as in the said act provided, from the said date so substituted in lieu of any prior date or dates mentioned in the said section.

"Nothing in this order shall be deemed to relieve any taxpayer from the liability to pay income tax and interest on any deficiency under section 48 of the said act."

Letter To The Editor

BANK RESERVES

I have been listening to the banking committee discussing bank reserves. I have also read a lot about it in the local papers and have spoken to my banker friends. I must admit I still don't know what the fuss is all about and I am ashamed of myself. I must be dumb for I have been intimately concerned with accounts, finance and even banking for more than forty years. Perhaps it is because I can't get an answer in the language I understand. Perhaps I am being too technical; or, as my grandmother used to say, "nasty particular".

It would all be clear to me if somebody could explain what happens, in terms of double entry bookkeeping. I find the older I get the more I respect the invincible logic of accounts.

I wish somebody would tell me which of these propositions is the correct one:

Assuming that the banks are permitted to depreciate the book value of their securities for income taxing purposes the following bookkeeping entries might be used:

1. Debit Profit and Loss, and credit Securities.
2. Debit Profit and Loss, and credit Reserve for Depreciation.
3. Debit some existing reserve account, and credit Securities.
4. Or nothing at all might be done about it beyond noting it on the back of an old envelope, and presumably, remembering it when making out income tax returns.

One gathers that some of the members of the banking committee feel that this sinister reserve is, to all intents and purposes, actual cash money which is kept in a nice leather bag and stored away in a dark corner of the vault.

Of course by my time of life I have learned that surpluses and reserves mean just this to many men who should know better. You would not believe how often I have been asked to produce in "cash money", reserves which were nothing more nor less than bookkeeping entries, probably designed to reduce apparent profits, and never by any chance funded. However, that is another story.

HARRY BALDWIN, C.A.

Ottawa, Can., June 17, 1944

Duplicate Estates Taxes

In the House of Commons on June 8, Prime Minister King made the following announcement regarding a convention between the U.S. and Canada on estates taxes and succession duties:

I wish to announce to the house that a convention for the avoidance of double taxation and the prevention of fiscal evasion in the case of estate taxes and succession duties was signed this afternoon, June 8, at 2.45 p.m. Mr. Atherton, the United States Ambassador, signed on behalf of the United States of America; and Mr. Mackenzie King, the Secretary of State for External Affairs, and Mr. Gibson, the Minister of National Revenue, signed for Canada. The text of the convention will be tabled in parliament, and an explanatory statement will be furnished as soon as arrangements have been completed in Washington for communicating the convention to the senate.

Supplementing this, the following statement was made in the House by the minister of national revenue on June 15:

As was announced by the prime minister last week, a tax convention was signed at Ottawa on the 8th of June, 1944, between Canada and the United States of America having for its objects the avoidance of double taxation and the prevention of fiscal evasion in the case of estate taxes imposed by the United States and the succession duties imposed by the parliament of Canada. I am now tabling the convention, and in the course of a few days a bill will be introduced for the purpose of ratifying the convention by parliament. For the information of the house I will give a brief outline of the convention.

Both countries have in the past applied the principle of the deceased's domicile as well as the principle of the local situation of the assets of deceased persons in the taxation of estates. The result has been that in many cases the personal property of deceased owners has been subject to dual taxation—once by the country in which the deceased was domiciled at the time of his death and again by the country in which some or all of his assets were situated at that time.

Real property was the only type of asset which escaped this dual imposition, as both the United States and Canada make no attempt to tax realty situated outside the boundaries of the taxing jurisdiction.

The problem of double taxation was intensified by the fact that the rules applied by the United States of America in determining the local situation of shares and stocks of corporations differ from those applied in Canada. In the United States the principle applied was that this class of property was subject to taxation if it was in any way regarded as being under the control of the taxing authority. For example, the shares of companies incorporated under the laws of the United States or any of the states and owned by a non-domiciled decedent and physically situated outside the United States at the time of death were deemed to have a situs within the United States regardless of whether the certificate was in the name of the deceased, or in street name, or other bearer form.

In Canada, on the other hand, stocks and shares were regarded as being situated where they could be effectively dealt with, namely, at the place of registration of the securities. Although this principle was much less sweeping in its operation than that in force in the

DUPLICATE ESTATES TAXES

United States, it nevertheless gave rise to considerable trouble in relation to companies having duplicate or multiple share registers.

Some cause of complaint has arisen in the past as to the method of determining the rates of taxation applicable to estates of non-domiciled decedents by reference to the entire value of such estates. Representations have been made that each country should fix the rates of taxation in such cases by the value of the property situated in the country which imposes the tax.

While Canada grants exemptions from taxation in estates of non-domiciled decedents in the proportion that the value of the property in Canada bears to the total value of the deceased's estate, this method of exemption has not been applied so far in the United States. That country grants only a nominal exemption of \$2,000 in all cases of non-domiciled decedents, notwithstanding that an exemption of \$100,000 is granted in the case of domiciled estates.

With a view to removing these causes of complaint, and particularly in order to avoid double taxation of estates in future, conversations recently took place between the taxing officials of both countries with the result that the tax convention was finally agreed upon.

The main features of the convention may thus be summarized:

Real property is to be taxed exclusively by the country wherein it is situated.

The country of domicile to have the right, at the outset, to tax all the personal property of the deceased, as heretofore.

The country of situs to have the right to tax the property situated within its boundaries.

The taxes paid in the country of situs are to be allowed as a credit against the taxes payable in the country of domicile which includes the same assets for tax purposes. The credit, however, is to be limited to that portion of the tax in the country of domicile that the value of the taxable property abroad is of the total value of the deceased's estate.

There is to be a uniform rule in determining the situs of shares of corporations. These shares are to be deemed to be situated and taxable in the country where the corporation is organized.

While the rules as to situs of other properties vary somewhat in the two countries, it is agreed that for the purpose of the convention, the situs of such other properties is to be determined by the laws of the country imposing the tax.

Each country is to take into account only the property therein situated when taxing the property of persons dying domiciled in the other country.

Exemptions to be granted estates of non-domiciled decedents are to be the same as those granted to estates of domiciled decedents, reduced, however, in direct proportion that the value of the property taxed abroad bears to the total value of the property wherever situated. Canada will benefit considerably by this provision, as, at the present time, the United States only allows an exemption of \$2,000 in the case of persons dying domiciled here, but this benefit is now only reciprocal to the benefit Canada always granted to the United States.

Articles VII to XIII of the convention are designed with a view to the exchange of information to prevent fiscal evasion. They are quite similar in scope to the provisions already in force with respect to income tax. By article XIV the convention is given a retroactive operation to 14th June, 1941, being the date when the original Dominion Succession Duty Act came into force. The convention is to remain in force for a period of five years from that date, and indefinitely thereafter, but may be terminated upon six months' notice at the end of the five year period or at any time thereafter.

Provincial News

British Columbia

On May 25th, the Committee on Education and Examinations, under the chairmanship of Mr. W. G. Rowe, met at a luncheon in honour of Mr. Francis Gordon-Cooper, on the eve of his departure to reside in Calgary, Alberta.

Mr. Gordon-Cooper had been very active and helpful in the education of the students of the British Columbia Institute for the past seven years, and the members present expressed their gratitude for his assistance, and regret at his departure from the province. They felt that though the British Columbia Institute would be losing him, the Alberta Institute would benefit by the acquisition of his vigorous and capable personality.

A small token of esteem was presented to Mr. Gordon-Cooper, with best wishes for success in his future endeavours.

New Brunswick

The annual meeting of The New Brunswick Institute of Chartered Accountants was held on June 7 at Saint John. The following officers were elected for the ensuing year: President, R. S. FitzRandolph; vice-president, W. J. B. Gentleman; secretary-treasurer, G. Andrew Oulton; additional members of the Council, David Reevey, H. L. McMackin, and A. G. Burnham; representatives of the Institute on the Council of The Dominion Association of Chartered Accountants, T. J. Hammett and George W. Hudson; auditor, R. E. Cox.

At the meeting routine matters of interest to the profession were discussed. Preliminary arrangements for the annual convention of The Dominion Association of Chartered Accountants also were planned. The convention is being held in Saint John this year from August 21 to 24.

Following the general meeting, the president of the New Brunswick Institute tendered a dinner at the Union Club in honor of Mr. H. G. Norman, president of The Dominion Association of Chartered Accountants, who arrived in the city from Montreal for the purpose of attending the annual meeting. Mr. Norman gave an address on the activities of the various committees of the Dominion Association. In

closing he drew attention to the chartered accountants' responsibilities and duties as leaders in the community. This applied, he said, not only to management and government but to the various spheres of public endeavour. He pointed out that chartered accountants, because of their training and other professional qualifications, were particularly suited for this type of work. He stressed the important factors relating to the particular work of chartered accountants in obtaining the true facts and presenting them in an independent and unbiased manner.

Messrs. J. D. Campbell, C. G. Rounding, and A. Tobias, chartered accountants of the Income Tax Division, Department of National Revenue, Ottawa, also were guests at the dinner.

Ontario

The Council of the Institute of Chartered Accountants of Ontario held a luncheon on June 15th for the advisory board of past presidents, with the purpose of discussing the progress and problems of the Institute in order to receive the benefit of past experience.

Twelve past presidents were able to be present and the Council benefited greatly from the discussion that followed. It is hoped that this event will become an annual affair.

In the afternoon a reception was given in the library of the Institute and the following eleven members were admitted as Fellows of the Institute: R. H. Bounsall, Ottawa; K. L. Carter, Toronto; J. G. Glassco, Toronto; W. L. Gordon, Toronto; V. D. Harbinson, Toronto; G. S. Jewell, London; S. G. Richardson, Hamilton; G. W. Smith, Toronto; A. S. Tindale, Ottawa; H. W. Vanstone, Toronto, and W. F. Williams, Ottawa.

Mr. Russel R. Grant, president, and other Fellows of the Institute welcomed those of the above members who were able to be present and Mr. Grant presented the certificates.

Personals

Peter S. Wise, B.Com., C.A., and Jack R. Stein, C.P.A., practising under the firm name of P. S. Wise and Company, accountants and auditors, announce the admission into partnership of Joseph G. Schwartz, C.A.

A. Murray Milne, C.A., formerly associated with the late H. W. Steele, under the firm name of Milne, Steele & Co., announces that he has now formed a partnership with Messrs. M. A. Honeywell, E. L. H. Burpee and P. L. Clarke, and will continue to practise his profession with them under the firm name of Milne, Honeywell, Burpee & Clarke, chartered accountants, Ottawa, Ontario.

Messrs. Rankin, Saul and Thornton, chartered accountants, Winnipeg, announce that they have admitted Stanley M. Milne, C.A., and Donald J. Campbell, C.A., as partners in the firm. Both Mr. Milne and Mr. Campbell have been associated with the firm for many years.

Mr. Ewen Rankin, C.A., has retired from active participation in the business of the firm.

Philip A. Gibbs, chartered accountant, has removed his offices to 403 Union Building, 612 View Street, Victoria, British Columbia.

James A. Hoyle, C.A., announces that he has opened an office as J. Hoyle and Sons, chartered accountants, at 235 Roy Building, Halifax, Nova Scotia, from where he will continue his professional practice.

Obituaries

The Late Alfred Shaw

The Institute of Chartered Accountants of British Columbia regrets to announce the death of Alfred Shaw on May 26th in California.

The late Mr. Shaw was admitted a member of the Institute in the year 1910 and made a Fellow in the year 1913. He became a member of the council on May 3, 1912, and served for four years, being president of the British Columbia Institute for 1913-1914 and president of the Dominion Association for 1914-1915.

Mr. Shaw had been retired for some years and was not, therefore, so well known to younger members of the profession, but the older members knew him as a trusty counsellor. He engaged largely in liquidation work, for which he was well fitted, having had extensive legal training. He was of Australian birth; and before coming to Canada, had studied in England and practised in South Africa. One of his most treasured possessions was a notarial appointment issued in the name of Queen Victoria under the seal of the Archbishop of Canterbury entitling him to practise as a notary in any part of the Queen's dominions. Although he was born and spent practically all his life in the outposts of the Empire, he bore the mark of his English ancestry and training, which always gave him the air of an old time gentleman. This did not prevent him dealing with practical issues; but this combination of classical scholar and accountant made his opinions on many semi-legal questions valuable, and these opinions were frequently sought by the judiciary, amongst whom he had many friends.

Mrs. Shaw predeceased him two years ago. His son, Cyril D. Shaw, was living with him in California and he is also survived by a daughter in Australia. To them the Institute offers its sympathy.

The Late Albert Edward Nash

The Institute of Chartered Accountants of Ontario regrets to announce the death, while on active service, of Major-General A. E. Nash, F.C.A., on June 4th in Montreal. General Nash, who was inspector-general of the Canadian army for central Canada, sustained a head injury while on inspection duties at Bowmanville, Ontario.

General Nash joined the Institute through affiliation from the Alberta Institute in 1921, in which province he commenced practice. He was a partner of the firm of Clarkson, Gordon, Dilworth and Nash since the present firm was organized. He was admitted a Fellow of the Institute in 1929 and elected to Council in 1934, and in 1939 was appointed secretary-treasurer. However, at the outbreak of war he resigned from this office to go on active service.

To his wife and three daughters the Institute offers sincere sympathy.

STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

NOTES AND COMMENT

These notes are being written two weeks after "D"-Day. All of us have in mind at this time those of our former office companions who are taking part in the assault on Normandy. Our hope and prayer is that good fortune may attend them and that their valour may hasten the day when they will be with us again.

* * *

Conservatism, a word constantly on the tongue of accountants, has recently been defined as "a disposition to resolve doubts in the measurement of assets or profit on the side of understatement". It is, however, a rather treacherous animal, for conservatism in the statement of assets or of results of operations in the past must lead to liberalism in the statement of the profits of a later period. The simplest demonstration of this is found in the conservative valuation of the inventory at the close of one accounting period. If this should be less than the fair value of the inventory the income of that period is understated; but inevitably the income of the succeeding period is overstated by like amount. A less obvious but perhaps more serious distortion that may result from the use of conservatism is found in the field of depreciable fixed assets. If such assets are brought on to the books, either originally or by a subsequent process of reorganization, at conservative values which prove to be less than true values then depreciation charges for all accounting periods falling within the life of the asset will be understated and earnings will be overstated. It is considerations such as these which lead to the conclusion that, while conservatism will not distort the cumulative total of earnings over the long run, it must be regarded as misleading by anyone whose interest is to get as accurate an apportionment to particular income periods as is attainable. Those accountants who place too much reliance on conservatism are failing to realize that "what goes up must come down". Conservatism would seem to be appropriate only when accuracy is unattainable by any reasonable amount of effort.

We were recently drawn into an argument with a group of economists on the subject of obsolescence as a business cost. We asserted (and we hope we shall not be repudiated by our professional brethren) that the accountant's depreciation charge included allowance for the factor of obsolescence and that it was not customary, except perhaps in utilities accounting to show an item of obsolescence in addition to an item of depreciation. *Either* wear and tear *or* obsolescence sets a term to the useful life of an asset; it is not possible for both to be operative. The accountant therefore charges as periodic depreciation that portion of the original cost of the asset which is deemed to have expired—basing his calculation on the term thus set whether it be set by physical factors or by risk of obsolescence. The economists argued that the loss by wear and tear (which they called depreciation) should be shown separately from the loss by obsolescence. So if there were acquired at a cost of \$100,000 a machine which had an estimated physical endurance of 20 years but which was expected to become obsolete in five years the operating costs would include as separate items: Depreciation \$5,000 (computed as $\frac{\$100,000}{20}$)

and obsolescence \$15,000 (computed as $\frac{\$100,000}{5} - 5,000$).

For ourselves we think that if the economists' view were to prevail the accountant should drop the word depreciation altogether and substitute "wear and tear". We should be interested in hearing from any of our readers who have strong views on this topic.

* * *

STUDENTS' ASSOCIATION NOTES

Ontario

The Chartered Accountants Students' Association of Ontario are happy to announce that P/O W. B. Gillespie, who was listed as missing after a raid over Germany on March 30th, is now reported a prisoner of war.

Word has been received from Britain that Wing Commander H. R. Dow has been appointed the new chief of the R.C.A.F. Iroquois Squadron. "Hank" Dow was a student with Clarkson, Gordon, Dilworth & Nash until September 1940 when he enlisted in the Air Force. We send heartiest congratulations to him and wish him every success.

The Chartered Accountants Students' Association of Ontario regret to report the death of P/O John Nisbet Thomson, while on active service. Mr. Thomson was attached to the Transport Command and burial took place at Reykjavik, Iceland.

Mr. Thomson was employed with Clarkson, Gordon, Dilworth & Nash and had successfully passed his primary examination. He enlisted immediately after writing this examination in 1942 and was commissioned in December 1943 as a navigator.

To his parents the Association offers its sincere sympathy.

PROBLEMS AND SOLUTIONS

THE PROVINCIAL INSTITUTES OF CHARTERED ACCOUNTANTS

Solutions presented in this section are prepared by practising members of the several provincial Institutes and represent the personal views and opinions of those members. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM I

INTERMEDIATE EXAMINATION, DECEMBER 1943

Accounting I, Question 3 (15 marks)

(a) A company purchases an asset for \$10,000 on 1st January 1940 and depreciates it on the sinking fund method over a three-year period. Cash is set aside annually in a sinking fund bank account which earns three per cent, credited annually.

Draft journal entries over the three-year period to cover the sinking fund requirements and close the accounts at the end of three years.

Sinking fund multiplier at 3% is .3235303.

(b) What are the advantages of the sinking fund method of depreciating assets?

SOLUTION

(a)			
1940			
Jan. 1	Asset	\$10,000.00	
	To Bank		\$10,000.00
Dec. 31	Sinking fund bank account	3,235.30	
	To Bank		3,235.30
	Transfer of annual cash requirement.		
	Depreciation	3,235.30	
	To Sinking fund reserve		3,235.30
	Charge for depreciation of asset for year to date.		

STUDENTS' DEPARTMENT

1941			
Dec. 31	Sinking fund bank account	97.06	
	To Sinking fund reserve		97.06
	Earnings on sinking fund assets for the year to date.		
	Sinking fund bank account	3,235.30	
	To Bank		3,235.30
	Transfer of annual cash requirement.		
	Depreciation	3,235.30	
	To Sinking fund reserve		3,235.30
	Charge for depreciation of asset for the year to date.		
1942			
Dec. 31	Sinking fund bank account	197.04	
	To Sinking fund reserve		197.04
	Earnings on sinking fund assets for the year to date.		
	Sinking fund bank account	3,235.30	
	To Bank		3,235.30
	Transfer of annual cash requirement.		
	Depreciation	3,235.30	
	To Sinking fund reserve		3,235.30
	Charge for depreciation of asset for the year to date.		
	Sinking fund reserve	10,000.00	
	To Asset		10,000.00
	Writing-off asset fully depreciated.		
	Bank	10,000.00	
	To Sinking fund bank account		10,000.00
	Transfer of cash accumulated.		

(b) The advantages of the sinking fund method of providing for depreciation are:

(1) The periodic charge for depreciation of the asset is less than that by the simple straight line method because the earnings on the assets conserved by the depreciation charge are applied in reduction of depreciation expense instead of being credited as income. (It is to be noted that there is no gain in net income unless the sinking fund investments earn a higher return than assets employed in the business—an unlikely situation.)

(2) It ensures that cash will be available for replacement (if so desired) of the asset at the end of its useful life.

PROBLEM II

FINAL EXAMINATION, DECEMBER 1943

Accounting II, Question 2 (15 marks)

A concern of moderate size manufactures four products, all of a somewhat similar nature. There are about a dozen distinct processes, some of which are common to all products, e.g., sanding, painting, etc. Considerable difficulty has been experienced in the distribution of direct labour, the system employed being based on an examination of the payroll and the allocation to each product of the salary of any worker known to be employed on it. However, it is a fairly common occurrence for a worker to be employed partially on one product and partially on others.

Required:

You have been asked for your advice as to what better method might be adopted and are required to outline briefly a system under which more accurate figures might be obtained, bearing in mind that the concern would like to establish some form of process costing.

SOLUTION

Since the concern manufactures only four products, it would seem logical to assign a symbol or code letter or number to each; thus, one product would be A or 1, another B or 2, the third C or 3 and the fourth D or 4. The various processes should then be given code numbers, such numbers being assigned in the order in which the processes occur. For example, if the sanding process came first, the number would be 1, and so on down the production line.

A system of time (or job) tickets should be introduced, as distinct from clock cards, which merely record the elapsed time of workers. The job card should be so drawn up as to provide spaces for:— (a) the worker's name; (b) his number; (c) the date; (d) the commencing and finishing time; (e) elapsed time; (f) rate of pay; (g) code number; (h) cost. Thus a worker engaged on the third process on product A would mark his card A-3 with the elapsed time. In the office, the rate of pay would be inserted and the cost calculated. The cards would be sorted first by product codes and afterwards by underlying process numbers. A further refinement would be to have different colours for each product, say white for A, blue for B, and so on. This facilitates sorting. It would be sufficient then to take adding machine tapes of the cards to obtain totals for each process for each product.

It should be noted that the total of the elapsed time on all job cards for any one worker should be compared with the total time as shown by his clock card. It will be understood that any worker may have several job cards in a day, but under a system such as is outlined above, his pay for the day should be properly allocated to the various products and underlying operations.

PROBLEM III

FINAL EXAMINATION, DECEMBER 1943

Accounting II, Question 3 (25 marks)

An engineering concern is engaged on government work in addition to its usual commercial activities. Government jobs (which bear the prefix "G" as against "C" for commercial work) are on a "cost plus" basis, the profit allowed being 5% of the total of material, labour and overhead, the latter item to be "spread" *pro rata* to direct labour.

At 1st January the work in process was valued as follows:

	G 11	G 15	C 290	Total
Material	\$18,000	\$26,000	\$ 8,000	\$52,000
Labour	26,000	22,000	18,000	66,000
Overhead	26,400	24,200	21,600	72,200
Profit (est.)	3,000	3,000	6,000
	<u>\$73,400</u>	<u>\$75,200</u>	<u>\$47,600</u>	<u>\$196,200</u>

During the six months to 30th June, the following amounts were expended on various jobs:

Government Work	Material	Labour	Total
G 11	\$ 48,000	\$ 64,000	\$112,000
G 15	34,000	30,000	64,000
G 16	8,000	10,000	18,000
G 17	29,000	46,000	75,000
	<u>\$119,000</u>	<u>\$150,000</u>	<u>\$269,000</u>

STUDENTS' DEPARTMENT

Commercial Work

C 290	\$ 41,000	\$ 32,000	\$ 73,000
C 291	11,000	10,000	21,000
C 292	14,000	8,000	22,000
	<u>\$ 66,000</u>	<u>\$ 50,000</u>	<u>\$116,000</u>

Overhead expense for the period was \$250,000, but this figure contains items totalling \$10,000 which are not admitted by the government auditors.

Jobs G 11, 15 and 16 are complete, but have not yet been billed; G 17 is still in process. Of the commercial work, C 291 and 292 were completed during the period and billed for \$37,500 and \$31,800 respectively; C 290 is still in progress, but it is estimated that it will be completed by the expenditure of \$2,000 for material and \$4,000 for labour. The contract price is \$175,000.

Required:

You are required to express an opinion as to what amount might reasonably be shown as manufacturing profit for the period, showing how you arrive at your figure.

SOLUTION

Summary of Costs—1st January to 30th June (cents omitted)

Job No.	Balance Forward	Material	Labour	Overhead	TOTAL	Profit	Selling Price
G 11	\$73,400	\$43,000	\$64,000	\$76,800	\$262,200	(A) \$9,960	\$272,160
G 15	75,200	34,000	30,000	36,000	175,200	(A) 5,610	180,810
G 16	—	8,000	10,000	12,000	30,000	1,500	31,500
G 17	—	29,000	46,000	55,200	130,200	6,510	136,710
Total Government Work	\$148,600	\$119,000	\$150,000	\$180,000	\$597,600	\$23,580	\$621,180
C 290	\$47,600	\$41,000	\$32,000	\$38,400	\$159,000	(B) \$4,000	\$163,000
C 291	—	11,000	10,000	12,000	33,000	4,500	37,500
C 292	—	14,000	8,000	9,600	31,600	200	31,800
Total Commercial Work	\$47,600	\$66,000	\$50,000	\$60,000	\$223,600	\$8,700	\$232,300
GRAND TOTAL	\$196,200	\$185,000	\$200,000	\$240,000	\$821,200	(C) \$32,280	\$853,480

		G 11	G 15
(A) Total cost as above		\$262,200	\$175,200
Less: Estimated profit at 1st Jan.		3,000	3,000
Actual cost		<u>\$259,200</u>	<u>\$172,200</u>
5% thereon		12,960	8,610
Less: Taken in previously		3,000	3,000
Balance		<u>\$ 9,960</u>	<u>\$ 5,610</u>
(B) Total selling price			\$175,000
Less: Estimated cost, to complete			
Material		\$2,000	
Labour		4,000	
Overhead, say 150% of labour		6,000	12,000
Value of work to date			<u>163,000</u>
Cost per summary			<u>159,000</u>

THE CANADIAN CHARTERED ACCOUNTANT

Estimated profit	\$ 4,000
(C) Profit as above	\$ 32,280
Less: Overhead unabsorbed	10,000
Net profit	\$ 22,280

NOTE: So far as overhead is concerned, the alternative method of "spreading" the total is to deduct \$180,000 (the amount absorbed on Government jobs) from \$250,000 and to "spread" the balance (\$70,000) over the commercial work at the rate of 140% of direct labour on that type of work (\$50,000). Either method would be accepted.

DISCUSSION OF PROBLEM SOLUTIONS

Winnipeg, Manitoba.
June 10, 1944.

The Editor,
The Students' Department.

Dear Sir:

In the June edition of *The C.C.A.* appears a solution to December 1943 Accounting I, question 3 (the first problem and solution) and the problem and solution do not appear to agree in the following particular:

In each of the years 1941 and 1942, the problem states "The Bad Debt Reserve should have been increased by \$5,000 (1941) \$3,000 (1942)." In 1941 the reserve was accordingly increased by \$5,000, but in 1942 instead of increasing it as the problem states it is reduced by \$2,000 and in 1943 \$6,000 is reversed.

If an auditor was to interpret a client's instructions in this regard, the answer would be:

1941—Dr. P. & L. \$5,000

1942—Dr. P. & L. 3,000

1943—Cr. P. & L. 3,000

It seems to me that the solution is rather far fetched.

Yours truly,

(Signed) EDWARD GABRIEL

[It seems to us that the information given in the problem relates specifically to individual years and that accordingly if an adjustment is made in any one year it must effect the amount of the required adjustment in the succeeding year. One of the most useful features of a problem of this kind is the test it affords of the candidate's appreciation of the fact that any adjustment made on the accounts of one period operates automatically as an adjustment in the reverse direction on the accounts of the succeeding period.—Editor.]

